(1) The full faith and credit obligations of a state, the District of Columbia, the Commonwealth of Puerto Rico, a territory or possession of the United States, or a political subdivision thereof that possesses general powers of taxation, including property taxation; or

(2) An obligation that is unconditionally guaranteed by an obligor possessing general powers of taxation, including property taxation.

Government agency means the United States or an agency, instrumentality, or corporation of the United States Government whose obligations are fully and explicitly insured or guaranteed as to the timely repayment of principal and interest by the full faith and credit of the United States Government.

Government-sponsored agency means an agency, instrumentality, or corporation chartered or established to serve public purposes specified by the United States Congress but whose obligations are not fully and explicitly insured or guaranteed by the full faith and credit of the United States Government, including but not limited to any Government-sponsored enterprise.

Liquid investments are assets that can be promptly converted into cash without significant loss to the investor. A security is liquid if the spread between its bid price and ask price is narrow and a reasonable amount can be sold at those prices promptly.

Long-Term Standby Purchase Commitment (LTSPC) is a commitment by Farmer Mac to purchase specified eligible loans on one or more undetermined future dates. In consideration for Farmer Mac's assumption of the credit risk on the specified loans underlying an LTSPC, Farmer Mac receives an annual commitment fee on the outstanding balance of those loans in monthly installments based on the outstanding balance of those loans.

Market risk means the risk to your financial condition because the value of your holdings may decline if interest rates or market prices change. Exposure to market risk is measured by assessing the effect of changing rates and prices on either the earnings or economic value of an individual instrument, a portfolio, or the entire Corporation.

Maturing obligations means maturing debt and other obligations that may be expected, such as buyouts of long-term standby purchase commitments or repurchases of agricultural mortgage securities.

Mortgage securities means securities that are either:

(1) Pass-through securities or participation certificates that represent ownership of a fractional undivided interest in a specified pool of residential (excluding home equity loans), multifamily or commercial mortgages, or

(2) A multiclass security (including collateralized mortgage obligations and real estate mortgage investment conduits) that is backed by a pool of residential, multifamily or commercial real estate mortgages, pass-through mortgage securities, or other multiclass mortgage securities.

(3) This definition does not include agricultural mortgage-backed securities guaranteed by Farmer Mac itself.

Nationally recognized statistical rating organization (NRSRO) means a rating organization that the Securities and Exchange Commission recognizes as an NRSRO.

Non-program investments means investments other than those in:

(1) ''Qualified loans'' as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended; or

(2) Securities collateralized by ''qualified loans.''

OSMO means FCA's Office of Secondary Market Oversight.

Program assets means on-balance sheet ''qualified loans'' as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended.

Program obligations means off-balance sheet ''qualified loans'' as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended.

Regulatory capital means your core capital plus an allowance for losses and guarantee claims, as determined in accordance with generally accepted accounting principles.

Revenue bond means an obligation of a municipal government that finances a specific project or enterprise, but it is not a full faith and credit obligation. The obligor pays a portion of the revenue generated by the project or enterprise to the bondholders.

Weighted average life (WAL) means the average time until the investor receives the principal on a security, weighted by the size of each principal payment and calculated under specified prepayment assumptions.

§ 652.10 Investment management and requirements.

(a) *Investment policies—board responsibilities.* Your board of directors must adopt written policies for managing your non-program investment activities. Your board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At least annually, your board, or a designated subcommittee of the board, must review these investment policies. Any changes to the policies must be adopted by the board. You must report any changes to these policies to FCA's Office of Secondary Market Oversight within 10 business days of adoption.

(b) *Investment policies—general requirements*. Your investment policies must address the purposes and objectives of investments, risk tolerance, delegations of authority, exception parameters, securities valuation, internal controls, and reporting requirements. Furthermore, the policies must address the means for reporting, and approvals needed for, exceptions to established policies. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of your investments.

(c) *Investment policies—risk tolerance*. Your investment policies must establish risk limits and diversification requirements for the various classes of eligible investments and for the entire investment portfolio. These policies must ensure that you maintain prudent diversification of your investment portfolio. Risk limits must be based on the Corporation's objectives, capital position, and risk tolerance. Your policies must identify the types and quantity of investments that you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. Your policies must establish risk limits for the following four types of risk:

(1) *Credit risk*. Your investment policies must establish:

(i) Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations based on a single or related counterparty(ies), a geographical area, industries or obligations with similar characteristics.

(ii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your annual review of your investment policies, your board of directors, or a designated subcommittee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board. Also, as part of your annual review, the board, or a designated subcommittee of the board, must review existing relationships with securities firms. In addition, the board, or a designated subcommittee of the board, must be notified before any changes to securities firms are made.

(iii) Collateral margin requirements on repurchase agreements. You must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) *Market risk*. Your investment policies must set market risk limits for specific types of investments, and for the investment portfolio or for Farmer Mac generally. Your board of directors must establish market risk limits in accordance with these regulations (including, but not limited to, §§ 652.15 and 652.40) and our other policies and guidance. You must document in the Corporation's records or minutes any analyses used in formulating your policies or amendments to the policies.

(3) *Liquidity risk*. Your investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and the Corporation's objectives.

(4) *Operational risk*. Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) *Delegation of authority*. All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls*. You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties and supervision between personnel who execute investment transactions and personnel who approve, revaluate, and oversee investments.

(3) Maintain records and management information systems that are appropriate for the level and complexity of your investment activities.

(f) *Securities valuations*. (1) Before you purchase a security, you must evaluate its credit quality and price sensitivity to changes in market interest rates. You must also verify the value of a security that you plan to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction. Your investment policies must fully address the extent of the prepurchase analysis that management needs to perform for various classes of instruments. For example, you should specifically describe the stress tests in § 652.40 that must be performed on various types of mortgage securities.

(2) At least monthly, you must determine the fair market value of each security in your portfolio and the fair market value of your whole investment portfolio. In doing so you must also evaluate the credit quality and price sensitivity to the change in market interest rates of each security in your portfolio and your whole investment portfolio.

(3) Before you sell a security, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board of directors.* At least quarterly, Farmer Mac's management must report to the Corporation's board of directors, or a designated subcommittee of the board:

(1) On the performance and risk of each class of investments and the entire investment portfolio;

(2) All gains and losses that you incur during the quarter on individual securities that you sold before maturity and why they were liquidated;

(3) Potential risk exposure to changes in market interest rates and any other factors that may affect the value of your investment holdings;

(4) How investments affect your overall financial condition;

(5) Whether the performance of the investment portfolio effectively achieves the board's objectives; and

(6) Any deviations from the board's policies. These deviations must be formally approved by the board of directors.

EFFECTIVE DATE NOTE: At 77 FR 66382, Nov. 5, 2012, § 652.10 was revised, effective 30 days after publication in the FEDERAL REGISTER during which either or both Houses of Congress are in session. For the convenience of the user, the revised text is set forth as follows:

§ 652.10 Investment management.

(a) *Responsibilities of the board of directors.* Your board of directors must adopt written policies for managing your non-program investment activities. Your board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At least annually, your board, or a designated committee of the board, must review the sufficiency of these investment policies. Any changes to the policies must be adopted by the board. You must report any changes to these policies to the OSMO within 10 business days of adoption.

(b) *Investment policies—general requirements.* Your investment policies must address the purposes and objectives of investments, risk tolerance, delegations of authority, internal controls, due diligence, and reporting requirements. Moreover, your investment policies must fully address the extent of pre-purchase analysis that management must perform for various types, classes, and structure of investments. Furthermore, the policies must include reporting requirements and approvals needed for exceptions to the board's policies. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of your investments. You must document in the Corporation's records any analyses used in formulating your policies or amendments to the policies.

(c) *Investment policies—risk tolerance.* Your investment policies must establish risk limits for the various types, classes, and sectors of eligible investments. These policies must include concentration limits to ensure prudent diversification of credit, market, and liquidity risks in the investment portfolio. Risk limits must be based on all relevant factors, including the Corporation's objectives, capital position, earnings, and quality and reliability of risk management systems. Your policies must identify the types and quantity of investments that you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. Your policies must establish risk limits for the following four types of risk:

(1) *Credit risk.* Your investment policies must establish:

(i) Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations in a single or related counterparty(ies), geographical areas, industry sectors, and asset classes or obligations with similar characteristics.

(ii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your review of your investment policies required under paragraph (a) of this section, your board of directors, or a designated committee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board.

(iii) Collateral margin requirements on repurchase agreements. You must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) *Market risk*. Your investment policies must set market risk limits for specific types of investments and for the investment portfolio.

(3) *Liquidity risk*. Your investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and the Corporation's other objectives.

(4) *Operational risk*. Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) *Delegation of authority*. All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls*. You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties between personnel who supervise or execute investment transactions and personnel who supervise or engage in all other investment-related functions.

(3) Maintain records and management information systems that are appropriate for the level and complexity of your investment activities.

(4) Implement an effective internal audit program to review, at least annually, your investment management functions, controls, processes, and compliance with FCA regulations. The scope of the annual review must be appropriate for the size, risk, and complexity of the investment portfolio.

(f) *Due diligence*—(1) *Pre-purchase analysis*—(i) *Objective, eligibility, and compliance with investment policies*. Before you purchase an investment, you must conduct sufficient due diligence to determine whether the investment is eligible under § 652.20, is for an authorized purpose under § 652.15(a), and complies with your board-approved investment policies. You must document its eligibility, purpose, and investment policy compliance and your investment objective. Your investment policies must fully address the extent of pre-purchase analysis that management must perform for various types, classes, and structure of investments. Your board must approve your decision to hold an investment that does not comply with your written investment policy requirements.

(ii) *Valuation*. Prior to purchase, you must verify the value of the investment (unless it is a new issue) with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(iii) *Risk assessment*. Your risk assessment must be documented and, at a minimum, include an evaluation of credit risk, market risk, and liquidity risk and the underlying collateral of the investment. You must conduct stress testing before you purchase any investment that is structured or that has uncertain cash flows, including all mortgage-backed securities or asset-backed securities. The stress testing must be commensurate with the risk and complexity of the investments and must comply with the requirements of paragraph (f)(4) of this section.

(2) *Monthly fair value determination*. At least monthly, you must determine the fair market value of each investment in your portfolio and the fair market value of your whole investment portfolio.

(3) *Ongoing analysis of credit risk*. You must establish and maintain processes to monitor and evaluate changes in the credit quality of each security and the whole investment portfolio on an ongoing basis.

(4) *Quarterly stress testing*. (i) You must stress test your entire investment portfolio, including stress tests of all investments individually and stress tests of the portfolio as a whole, at the end of each quarter. The stress tests must enable you to determine that your investment securities, both individually and on a portfolio-wide basis, do not expose your capital, earnings, or liquidity to risks that exceed the risk tolerance specified in your investment policies. If your portfolio risk exceeds your investment policy limits, you must develop a plan to reduce risk and comply with your investment policy limits.

(ii) Your stress tests must be comprehensive and appropriate for the risk profile of your investment portfolio and the Corporation. At a minimum, the stress tests must be able to measure the price sensitivity of investments over a range of possible interest rate/yield curve scenarios. The methodology that you use to analyze investment securities must be appropriate for the complexity, structure, and cash flows of the investments in your portfolio. You must rely to the maximum extent practicable on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions, when you apply your stress tests. Your assumptions must be prudent and based on sound judgment, and you must document the basis for all assumptions that you use to evaluate the security and its underlying collateral. You must also document all subsequent changes in your assumptions.

(5) *Presale value verification*. Before you sell an investment, you must verify its value with a source that is independent of the

broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board of directors.* At least quarterly, executive management must report on the following to the board of directors or a designated committee of the board:

(1) Plans and strategies for achieving the board's objectives for the investment portfolio;

(2) Whether the investment portfolio effectively achieves the board's objectives;

(3) The current composition, quality, and liquidity profile of the investment portfolio;

(4) The performance of each class of investments and the entire investment portfolio, including all gains and losses that you incurred during the quarter on individual securities that you sold before maturity and why they were liquidated;

(5) Potential risk exposure to changes in market interest rates as identified through quarterly stress testing and any other factors that may affect the value of your investment holdings;

(6) How investments affect your capital, earnings, and overall financial condition;

(7) Any deviations from the board's policies. These deviations must be formally approved by the board of directors.

§ 652.15 Interest rate risk management and requirements.

(a) The board of directors of Farmer Mac must provide effective oversight (direction, controls, and supervision) to the interest rate risk management program and must be knowledgeable of the nature and level of interest rate risk taken by Farmer Mac.

(b) The management of Farmer Mac must ensure that interest rate risk is properly managed on both a long-range and a day-to-day basis.

(c) The board of directors of Farmer Mac must adopt an interest rate risk management policy that establishes appropriate interest rate risk exposure limits based on the Corporation's risk-bearing capacity and reporting requirements in accordance with paragraphs (d) and (e) of this section. At least annually, the board of directors, or a designated subcommittee of the board, must review the policy. Any changes to the policy must be approved by the board of directors. You must report any changes to the policy to FCA's Office of Secondary Market Oversight within 10 business days of adoption.

(d) The interest rate risk management policy must, at a minimum:

(1) Address the purpose and objectives of interest rate risk management;

(2) Identify and analyze the causes of interest rate risks within Farmer Mac's existing balance sheet structure;

(3) Require Farmer Mac to measure the potential impact of these risks on projected earnings and market values by conducting interest rate shock tests and simulations of multiple economic scenarios at least quarterly;

(4) Describe and implement actions needed to obtain Farmer Mac's desired risk management objectives;

(5) Document the objectives that Farmer Mac is attempting to achieve by purchasing eligible investments that are authorized by § 652.35 of this subpart;

(6) Require Farmer Mac to evaluate and document, at least quarterly, whether these investments have actually met the objectives stated under paragraph (d)(4) of this section;

(7) Identify exception parameters and post approvals needed for any exceptions to the policy's requirements;

(8) Describe delegations of authority; and

(9) Describe reporting requirements, including exceptions to policy limits.

(e) At least quarterly, Farmer Mac's management must report to the Corporation's board of directors, or a designated subcommittee of the board, describing the nature and level of interest rate risk exposure. Any deviations from the board's policy on interest rate risk must be specifically identified in the report and approved by the board, or a designated subcommittee of the board.

EFFECTIVE DATE NOTE: At 77 FR 66382, Nov. 5, 2012, § 652.15 was revised, effective 30 days after publication in the FEDERAL REGISTER during which either or both Houses of Congress are in session. For the convenience of the user, the revised text is set forth as follows:

§ 652.15 Non-program investment purposes and limitation.

(a) Farmer Mac is authorized to hold eligible non-program investments listed under § 652.20 for the purposes of enterprise risk management, including complying with its interest rate risk requirements in § 652.30; complying with its liquidity requirements in § 652.40; managing surplus short-term funds; and complementing program business activities.